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PROFIT AND LOSS STATEMENT AND BALANCE SHEET OF A COMMERCIAL ENTERPRISE IN CHINA IN 1950

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[Comment: This report presents information on accounting theories and principles used in the profit and loss statement and balance sheet, and includes a hypothetical profit and loss statement and balance sheet of a commercial enterprise operating in China in June 1950. An outline is given for determining the net income in the profit and loss statement. The assets, liabilities, and net worth divisions of the balance sheet are also explained.]

Profit and Loss Statement

The profit and loss statement contains the income and expense items of an enterprise. The balance of these two items gives net income or net loss. The following regulations governing the procedure for determining the net income were issued by the Ministry of Finance on 21 December 1950. These regulations pertain to the implementation of provisional tax laws for industrial and commercial enterprises.

1. Total sales minus returned sales and allowances equals net sales

2. Beginning inventory plus (purchases minus returned purchases and allowances) plus cost of purchases minus inventory at the end of the period equals cost of goods sold

3. Net sales minus cost of goods sold equals gross profit on sales

4. Gross profit on sales minus (selling expenses plus administration expenses plus financial expenses) equals net profit on operations

5. Net profit on operations plus nonoperations income minus nonoperations loss equals net income

6. Net income times income tax rate equals income tax

Cost of purchases includes freight [in], insurance and taxes on goods. Financial expenses include interest, draft expense and discounts. Nonoperations income includes interest and rent on property, and profits made on the sale of fixed assets. Nonoperations expenses include a loss on the sale of a fixed asset, and losses caused by fire and flood. Nonoperations income and expenses are listed as other income and other expenses in the accompanying profit and loss statement.

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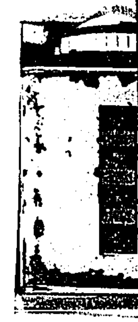

Profit and Loss Statement of Commercial Enterprise "X"

1 January-30 June 1950

Sales Income (yuan)			Cost of Goods Sold (yuan)		
Gross sales		7,551,439.00	Inventory (beginning of period)	2,158,439.00	
			Purchases	6,043,243.00	8,201,682.00
			Subtract inventory at end of period		2,238,763.00
					5,962,919.00
			[Gross] profit on sales		1,588,520.00
		7,551,439.00			7,551,439.00
[Gross] profit on sales		1,588,520.00	Expense items		
			Selling expenses		787,036.00
			Advertising	353,828.00	
			Salesmen's salaries	131,160.00	
			Freight out	302,048.00	
			Administrative expenses		762,290.00
			Salary	521,756.00	
			Managerial expenses	195,534.00	
			Depreciation	45,000.00	
			Net profit on operations		39,194.00
		1,588,520.00			1,588,520.00
Net profit on operations		39,194.00			
Other income		240,610.00	Other expenses		
Rent	237,160.00		Interest expenses		110,000.00
Interest	3,450.00		Net income		169,804.00
		279,804.00			279,804.00

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Balance Sheet

Such items as cash, buildings, inventory, and raw materials are a form of capital. They are also the assets of an enterprise. If an enterprise has assets of 10,000 yuan, and if the owners have equities in all the assets, then the owners have a capital of 10,000 yuan, or assets equals capital.

However, it is necessary that an enterprise have creditors. The creditors' equity in the assets cannot be clearly distinguished, but the assets equal the total of the owners' equity and the creditors' equity. The creditors' equity represents a lien on the assets, which is a liability to the owner as indicated in the equation assets equals liabilities plus capital. "Capital" in this equation represents the owners' equity in the assets, and "liabilities" represent the creditors' equity in the assets. This equation can be reversed as follows: assets minus liabilities equals capital.

The purpose of the balance sheet is to show clearly the changes in the resulting balance after liabilities are subtracted from assets, and its relation to the original investment by the owners. That part of the balance sheet that indicates this change is called "net worth," and may reflect a loss or a profit. Thus assets minus liabilities equals capital minus loss, or assets minus liabilities equals capital plus profit. The "capital minus loss", or "capital plus profit" is the net worth or the owners' equity in the assets. Therefore, according to accounting principles, assets minus liabilities equals net worth, or assets equals liabilities plus net worth.

When arranging the items on the balance sheet, current or short-term asset items should be listed first in the asset column under "current assets". These items include accounts receivable, notes receivable, inventory, and all items that are easily coverted to cash. Other items such as buildings and equipment are more permanent. Although they may be sold, the enterprise is not in business to sell them, and they are listed under "fixed assets." Items such as supplies inventory and prepaid expenses are listed under "deferred assets" because, although they cannot be converted to cash, these items will reduce future expenses.

Under "current liabilities" on the liability side of the balance sheet, such short-term obligations as accounts payable, notes payable, and short-term loans will be listed. Debentures, bonds, and long-term loans will be listed under "fixed liabilities."

Under "deferred liabilities" will be listed those items in which the amount earned was less than the amount collected. This will reduce the amount received in the future, make it a liability. "Net worth" will be listed after deferred liabilities. Since this account is small, it need not be subdivided.

"Reserve for depreciation" and "reserve for bad debts" are valuation accounts. They permit the original amount of the asset to be shown, and also indicate its current [book] value. The current value is determined by deducting the reserve from the original amount of the asset. The reserve account should be listed directly under the account it pertains to in the balance sheet. The following balance sheet observes the above procedure:

Balance Sheet of Commercial Enterprise "X" for the Period Ending 30 June 1950

Assets (yuan)		
Current assets		6,645,983.00
Cash		215,849.00
Bank Account		346,758.00
Notes receivable	1,587,040.00	
Accounts receivable	2,329,637.00	
	3,916,677.00	
Deduct reserve for bad debts	75,514.00	
		3,841,163.00
Interest receivable		3,450.00
Inventory		2,238,763.00
Deferred assets		68,540.00
Prepaid expenses		60,000.00
Supplies inventory		8,540.00
Fixed assets		3,155,000.00
Property	2,800,000.00	
Deduct reserve for depreciation	25,000.00	2,775,000.00
Capital equipment	400,000.00	
Deduct reserve for depreciation	20,000.00	380,000.00
		9,869,523.00

Liabilities (yuan)	
Current liabilities	3,478,179.00
Notes payable	1,186,000.00
Accounts payable	2,144,679.00
Interest payable	60,000.00
Salaries payable	87,500.00
Deferred liabilities	21,540.00
Deferred rent income	21,540.00
Fixed liabilities	1,200,000.00
Long-term loans	1,200,000.00
Total liabilities	4,699,719.00
Net Worth	
Owner's capital	5,000,000.00
Profit for this period	169,804.00
Total net worth	5,169,804.00
	9,869,523.00

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